

Testimony of
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Conservation, Credit, Rural Development and Research
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Good morning Mr. Chairman and members of the committee. Thank you for inviting me to testify here today and for allowing me to present the Farm Credit System's view on agricultural credit conditions and on credit-related proposals for the next Farm Bill.

My name is Andy Lowrey. I am President and Chief Executive Officer of *AgFirst Farm Credit Bank*. *AgFirst* provides loans and related services to more than 79,000 farmers, ranchers, agribusinesses and rural homeowners in 15 Mid-Atlantic and Southern states as well as the Commonwealth of Puerto Rico. We have 24 Agricultural Credit Associations that serve local communities throughout our states and employ over 1,800 people. Our assets total \$13.5 billion. As a cooperative, *AgFirst Farm Credit Bank* and its affiliated associations are owned and governed by their customers. Our boards are made up of members elected by our stockholders. Working together with our associations, we tailor our business to meet the needs of our customers.

Today, I am appearing on behalf of the entire Farm Credit System. Farm Credit institutions provided just over 26 percent of total farm business debt used by America's farmers and ranchers in 2000. In total, Farm Credit has more than \$75 billion in loans outstanding to agricultural producers, farmer-owned cooperatives, rural telecommunications and utility systems, rural homebuyers, and agriculturally related businesses. Farm Credit is the dominant lender for agricultural cooperatives and the single biggest source of financing for the GSM agricultural export loan guarantee program.

In my testimony today, I want to provide the committee with an update on Farm Credit's mission and our success in achieving it. I will provide Farm Credit's current assessment of the rural and agricultural credit markets. And finally, I will identify legislative changes that are needed if Farm Credit is to continue to fulfill the role Congress established for it.

Before I proceed with my testimony, however, I want to give the committee an update on agriculture and credit conditions in *AgFirst's* territory. Our area is blessed with a high degree of crop and livestock diversification. However, adverse weather, low prices and increasing cost, especially for fuel, have created economic stress in portions of our portfolio. This has not currently affected our overall

credit quality, but indications are that again in 2001, as in the past two years, many crop producers are facing extremely challenging times. While conditions in the poultry and livestock sector are generally more favorable, the dairy industry is just recovering from very low prices in 2000.

Recent years' returns from farming operations have in many cases been negative despite very significant federal government support of segments of the agricultural industry. The globalization of agricultural markets continues to put pressure on a number of specialty and high value crops.

We can readily see the positive impact of federal assistance. The congress has been far-sighted in providing economic assistance to rural communities whose viability is largely built around the ag sector. As cooperative owned and operating lending institutions, the AgFirst family is highly cognizant of the importance of value creation among our borrowers. In these tough economic times for farmers, government and the cooperative sector, together, are valuable contributors to the economic well being of the rural population. Our organizations are well capitalized and positioned to provide a solid support of loans to credit worthy farmers and to agribusiness, while also providing a patronage dividend from our earnings. There are indications in our territory that availability of ag credit from commercial banks today is shrinking. This is true as a result of consolidations and the low market returns to the industry. Our farmer boards of directors and management recognize the cyclical nature of ag markets and are committed to using all the tools available, including FSA and loan guarantees to work with borrowers under stress during the current down turn.

Our cooperatives' approach is to be fully supportive of not only full time farmers, but also of part time farmers and rural residents, especially to meet their housing loan needs. This approach has served our institutions well as the significant level of non-farm income supporting the repayment capacity of our loans is the highest in the Farm Credit System. Our credit quality reflects this advantage. While it is a result partially of geography and demographics, it also is a result of strategy and a solid, well-identified business focus.

On behalf of everyone in Farm Credit, I want to express our gratitude for the committee's efforts over the past several years to help American agricultural producers through this period of extremely low commodity prices. The additional assistance provided has meant the difference between survival and bankruptcy for many farmers. We encourage the committee to continue to provide additional support for producers during this difficult time.

Through the difficulties experienced by our customers, Farm Credit remains steadfast in its resolve to do all we can do to help our customers. Having a strong lender who understands these difficulties and who can serve the many needs of these customers is vital to keep their operations healthy in the long-term.

I'm pleased to report the *AgFirst Farm Credit Bank* and its affiliated associations continue to be a strong source of credit for the agricultural community. In 2000, our success was evident in our numbers.

- Net income increased 7.5 percent
- Loan volume grew by more than 9 percent

- Credit quality remains high
- Return on average assets was 1.85 percent, and return on average equity was 11.05 percent.

There are three reasons that contribute to our continued ability to deliver value to our stockholders and the marketplace.

First, our business model works. We believe it works because we focus on a few simple, but sound principles.

- *We make sound constructive loans.* Collectively, sound and constructive loans create a high quality loan portfolio. And that equates to stable and consistent earnings. America's farmers need a solid source of credit that will be around to help them not just today but well into the future. We work closely with our customers to help them be successful in the long run.
- *We believe our patrons – our member/borrowers – should share in the success of their cooperative.* In April of this year, we returned value to our stockholder-customers by providing over \$172 million in patronage refunds.
- *Our stable, consistent earnings have made it possible for us to pay patronage refunds consistently.* Associations in the Ag**First** family have paid patronage refunds to their member-borrowers each year since 1989, distributing more than \$1.4 billion in those 12 years. That's an average of almost 25 cents of every \$1.00 of interest earned. \$804 million was distributed in cash. This money flows to their local communities, so that rural America can continue to thrive and grow. It also helps farmers cover operating and living expenses.
- *We believe in providing good customer service.* And we do. Again, the evidence is in the numbers. In a recent Gallup survey, borrowers throughout the Ag**First** District reported a satisfaction rating of 9 on a 10-point scale. Furthermore, 99 percent of them said they would recommend us to others. Most cite our people and the quality of service they provide as the reasons they would recommend Farm Credit to others.

Secondly, our business model helps us attract new, high quality business. Since 1995, we've distributed more than \$800 million in patronage refunds and, during that five-year period, our loan volume has grown by 23.5 percent. Our credit quality is high, as evidenced by the fact that our nonaccruing loans were only 0.60 percent of total loans at the end of 2000.

Thirdly, our associations take advantage of our federated cooperative structure to control costs. Certain tasks are centralized at the bank level. Typically, these are the "operations center" sort of tasks. Through these efficiencies, our associations are able to focus on their customers more fully as far as their loan and financial service needs. In addition, their ability to control their costs allows them to return value to their customers through patronage.

Through our success, we believe that we will continue to fulfill the Farm Credit mission.

Farm Credit's Mission

As America's largest cooperatively owned agricultural lender, we in Farm Credit appreciate the committee's focus on the credit needs of agriculture. We believe that Farm Credit has played a vital role in the development of American agriculture as the most productive in the world. As agriculture has changed through the years, Farm Credit has kept pace and provided the capital necessary to fuel agriculture's productivity. We continue to do so today. As we look to the future, however, additional changes are needed if farmers and ranchers are to continue to have a cooperatively owned financing alternative available for them.

The Farm Credit System was created by Congress in 1916 to provide American agriculture with the dependable and affordable source of credit it needed -- through good times and bad. For 85 years now, Farm Credit has successfully fulfilled that mission.

Farm Credit has a specific, but critical mission: to help ensure the health and well-being of American agriculture by providing a dependable and competitive source of financing to rural America. Farm Credit's constant presence in the marketplace means that farmers have a choice among lenders. The competition between Farm Credit and other lenders creates competition for farm loans and results in interest rates that are competitive with other industries and in higher service levels for farmers and rural businesses. Our focus on agriculture means farmers and ranchers and their cooperatives have a reliable source of credit.

Mr. Chairman, as you well know, Farm Credit is not the lender of last resort. Congress has assigned that duty to the USDA's Farm Service Agency. Farm Credit is not in place to address a market failure. Instead, Congress assigned Farm Credit the job of "providing sound, adequate, and constructive credit and closely related services to farmers, cooperatives and selected farm-related business" (12 U.S.C. 2001(a)). When Congress recodified the law governing the Farm Credit System in 1971, it stated Farm Credit's mission very clearly -- "to encourage farmer- and rancher borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit" (12 U.S.C. 2001(b)).

By giving agricultural producers an opportunity, through Farm Credit, to own and control their lending institutions, Congress ensured that producers would always have access to credit. Farm Credit is dedicated to serving the financial needs of U.S. agricultural producers and rural communities.

Reversing the Flow of Capital -- Congress designed Farm Credit to reverse the usual flow of capital, channeling private funds from the nation's money markets to rural America. As agriculture's Government-sponsored enterprise (GSE), Farm Credit raises money on Wall Street to lend to agriculture and other rural enterprises.

Ensuring Competition for Farm Loans -- In its early years, Farm Credit, through the old Federal Land Banks, was virtually the only long-term mortgage lender to American farmers and ranchers. Over the years, others, including commercial banks and insurance companies, have come in and out of the market. As the agricultural credit markets evolved, Farm Credit served as the constant force in the

market. Other lenders, when they chose to engage in agricultural lending, were forced to compete with Farm Credit. This competition provided competitive interest rates and better loan terms to farmers. Farm Credit continues in this role today, serving as the only constant and reliable source of competitive pressure in the agricultural lending markets.

Farmer Control -- In addition to fostering competition for agricultural loans, Farm Credit gives producers and their cooperatives an opportunity to own their own lender. FCS banks and associations are cooperatives, owned and governed by the farmers, ranchers, and cooperatives that borrow from them. This cooperative principle is the foundation upon which Farm Credit is built. It guarantees Farm Credit's unwavering commitment to serving agriculture and rural communities.

GSE Status -- To help fulfill its commitment to serve agriculture all across the country, Congress provides Farm Credit with the ability to access the agency debt markets. As a GSE, Farm Credit benefits from the implicit backing of the federal government. This implied support allows us to maintain a triple-A credit rating in the bond markets.

Farm Credit uses this credit rating to gather loanable funds in a cost-effective manner. In this regard, GSE status is Farm Credit's counterpart to deposit insurance, which allows commercial banks to attract depositors at a lower cost. An important difference between the two is that GSEs have *implicit* government support while federal deposit insurance is *explicitly* backed by the federal government.

Farm Credit Financial Discipline -- Farm Credit lending institutions are subject to the full regulatory and examination authority of an independent federal agency: the Farm Credit Administration. The three-member FCA board of directors is appointed by the president and confirmed by the Senate. Although Congress sets the FCA's annual budget, the agency's operating costs (approximately \$38 million in 2000) are paid entirely by the lending institutions it regulates.

Like other federal financial regulators, FCA routinely examines all Farm Credit lending institutions, and has full authority to issue cease-and-desist orders, levy civil money penalties, remove officers and directors of System institutions and establish financial and operating reporting requirements.

Besides federal regulation, all Farm Credit lending institutions have additional financial safeguards:

- **Risk-Based Capital Standards** - By law, FCA requires all Farm Credit System lending institutions to maintain minimum permanent capital equity ratio at 7 percent of risk-adjusted assets. All System lenders are well above this minimum level.
- **Contractual Interbank Performance Agreement** - All FCS Banks, the Funding Corporation, and the Financial Assistance Corporation have entered into an agreement that establishes an agreed-upon standard of financial condition and performance for the banks.
- **Insurance Fund** - With passage of the Farm Credit Act of 1987, Farm Credit banks began paying into the Farm Credit System Insurance Fund. The Fund exists to insure the

timely payment of principal and interest on insured obligations of System banks. On December 31, 2000, the fund totaled some \$1.626 billion.

- **Joint and Several Liability** - By law, all of the banks within the Farm Credit System guarantee the payment of principal and interest on Systemwide debt issued to raise loanable funds on the money markets.

In summary, Farm Credit has been a success story. Congress authorized the nation's farmers and ranchers to build a **privately owned system** that brings the financial resources of Wall Street to agriculture and rural communities. It ensures **fair competition** in the marketplace that keeps interest rates competitive. And finally, through its cooperative principles, it ensures a continued strong **financial commitment** to all agricultural producers having a basis for credit -- in good times and bad. All this adds up to value being delivered by the System.

Rural and Agricultural Credit Markets

Farm Credit's financial condition remains strong despite extraordinarily low commodity prices. This financial strength is due, in large measure, to the high level of government payments to producers over the last several years. However, while there has been some strengthening of commodity prices this year, input costs, particularly fuel and related items, are high and rising. Lower interest rates are alleviating some stress, but most farmers continue to experience a cost/price squeeze. Complicating this predicament, some regions of the country are experiencing very unfavorable weather. As a result of all these factors, we expect that additional government assistance to farmers will again be necessary in 2001. We urge Congress to provide this assistance.

FCS Condition

Farm Credit continues to demonstrate financial strength in virtually all performance categories. Loan volume rose to \$76.031 billion in the first quarter of 2001 -- up some \$800 million compared to this time last year. Net income for the first quarter rose to \$390 million compared with \$312 million in the first quarter of 2000. Continued strong financial performance resulted in an increase in overall capital within the System to \$14.595 billion. Capital as a percentage of assets stood at 15.4 percent at March 31, 2001 compared to the regulatory minimum capital level of 7 percent required for individual FCS institutions. Farm Credit relies on this high level of capital to see it through the inevitable downturns in the agricultural economy.

Of note, Farm Credit's troubled loan volume rose in the first quarter, though it continues to stand at relatively low level. Nonperforming loans (which consist of nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due) increased \$67 million to \$946 million at March 31, 2001, as compared with \$879 million at December 31, 2000. These loans represented 1.24 percent and 1.17 percent of the System's loans at March 31, 2001 and December 31, 2000, respectively.

A recent survey of Farm Credit lenders provided an interesting insight to the current market conditions.

Reports of higher than normal turnover of agricultural land seem to be confirmed by increases in loan volume to both new and existing customers in most Farm Credit associations. Some 61 percent of responding System associations reported loan volume increases compared to one year ago. Half of System institutions reported that land values increased in the last six months while nearly the remainder reported that values were about the same as six months ago. For 2001, 32 percent of System institutions were expecting land values to increase while 61 percent were predicting values to remain steady. Only 6 percent predicted land values would fall in 2001.

Most System institutions see clouds on the horizon. Some 55 percent report that they expect an increase in troubled loans and other non-performing assets. In addition, a number of System loan officers are noting financial difficulties in farm related businesses. While farmers and landowners continue to benefit from government assistance, many agribusiness firms are struggling. In particular, input suppliers and marketing firms are being hard hit by the continuing downturn in prices. We encourage the committee to closely examine the financial situation facing many of these businesses.

Market Structure and Competition

U.S. agricultural credit markets have changed dramatically in the past decade. Most of these changes, naturally, mirror the changes occurring in U.S. agriculture. As producers have changed their operations to adapt to the marketplace, agricultural lenders have adapted their practices and products to meet the changing financing needs of American agriculture.

Congress has played a role in this evolutionary process. As inadequacies appeared in financial markets, Congress has stepped in to fill the gaps. In just the past decade, Congress completely rewrote the nation's financial services laws. Starting in the mid-nineties, Congress allowed commercial banks to operate branches across state lines. This watershed legislation preceded a period of massive consolidation within the banking industry that resulted in the creation of the largest banks in the world. Congress, in the 1999 Gramm-Leach-Bliley legislation, completed its overhaul of depression-era banking laws, virtually demolishing the separation between banking, insurance and securities firms. As a result of this legislation, commercial banks now have virtually unlimited authority to offer products and services to meet a variety of financial needs.

In addition to expanding the authorities of commercial banks, Congress awarded them with nearly unfettered access to funding from GSEs. Prior to Gramm-Leach-Bliley, commercial banks could access the Federal Home Loan Bank System, Fannie Mae and Freddie Mac to fund loans for homebuyers. In addition, Congress had given banks GSE access for agricultural lending through Farmer Mac and the Farm Credit System.

With passage of Gramm-Leach-Bliley, however, banks were given direct GSE funding access through the Federal Home Loan Banks to support farm and rural business lending. As a result, a commercial bank today has access to GSE funding that is commensurate with the access provided to Farm Credit lending associations from Farm Credit Banks. The commercial bank, however, has been authorized by

Congress to provide a far broader range of products and services.

Commercial banks, in effect, are now GSEs with virtually unlimited operating authority. Meanwhile, Farm Credit's authorities remain basically unchanged since the Congress enacted the Farm Credit Act of 1971 – some thirty years ago.

By broadly expanding the authorities of commercial banks and, at the same time, providing them access to GSE funding, Congress has reshaped the competitive landscape between commercial banks and Farm Credit.

USDA's Economic Research Service, in its February 2001 edition of "Agricultural Income & Finance," illustrated this competitive trend. Noting that, "agricultural banks remained very profitable through the middle of 2000," the ERS showed that banks substantially grew their marketshare of agricultural loans. From 1990 through 2000, ERS data reveals that Farm Credit's share of total farm business debt remained fairly stable. Farm Credit held 25.9 percent in 1990 and 26.4 percent in 2000. Meanwhile, commercial bank share of that debt grew substantially, from 34.5 percent in 1990 to 41 percent in 2000.

The result of Farm Credit's presence in the marketplace is strong competition for agricultural lending opportunities. This competition is vigorous and it benefits agriculture and rural communities.

We support full and fair competition for agricultural loans among all financial industry participants. Our commercial bank colleagues also have said they support strong competition in the market place. However, they contend that the Farm Credit System has an unfair advantage in the market. Given the vast changes in law, their broad access to GSE funds, and the continuing high profits of commercial banks, these complaints are wholly without foundation.

Even the U.S. Treasury, long a well known critic of GSEs in general and Farm Credit in particular, acknowledged in a May 2, 2001 letter to the Farm Credit Administration that, "some of the System's competitors have also gained improved access to other GSE funding." The Treasury went on to note that this "fact complicates any assessment of the competitive environment in agricultural credit markets..."

In summary, vigorous competition between Farm Credit, commercial banks and other lenders is benefiting U.S. agricultural producers. Producers have choices among lenders, financial products and related services. In short, pricing is competitive, service is better because Farm Credit ensures competition in agricultural and rural credit markets. The more intense the competition, the greater the benefit for American agriculture.

USDA Credit Programs Appear to Be Working

This committee was instrumental in adding flexibility to the lending limits for FSA guaranteed loans. We

very much appreciate the flexibility allowed by the 1996 farm bill. It was a recognition of the changing financial reality of farming in many high-cost regions of the country.

As for additional changes, we encourage the committee to continue emphasis on the guaranteed loan program. We also would suggest allowing FSA the flexibility to guarantee a lease. Small farmers, particularly those just beginning their own operation, may be better off leasing land and equipment. FSA guarantees of these lease contracts would improve our ability to serve these farmers. We hope the committee will examine this issue closely as it debates the credit title of the Farm Bill.

Congress Can Help Meet Rural Credit Needs

Farm Credit is working hard to meet the changing financial needs of American agriculture. To continue to fulfill its mission going forward, however, Farm Credit needs to be equipped to meet the changing needs of agriculture and rural America.

First, Farm Credit's charter needs updating. Last changed materially in 1971, Farm Credit's lending authority is becoming outdated. Today and in the next century, producers are becoming more dependent on new and existing value-added agricultural businesses to provide markets for raw commodities. Farm Credit, agriculture's traditional lender, must be able to finance these operations. Unfortunately, we are unnecessarily restrained by an outdated charter from meeting their financing needs. Congress can and should modernize Farm Credit's charter during the next farm bill.

Second, and this might be more appropriate for a discussion of the rural development title of the Farm Bill, Farm Credit supports efforts to increase the availability of equity capital for farmer-owned cooperatives and other rural businesses. We recognize that rural America is not sharing fairly in the unprecedented prosperity of the rest of the country. There is a real need to more broadly diversify our rural economies and to generate new sources of equity capital for rural business development. We encourage the committee to consider legislation to encourage private investment in value-added agriculture enterprises, producer-owned cooperatives, and other projects that existing venture capital funds do not accommodate. These types of investments would provide off-farm income, additional markets for agricultural products, and new business opportunities in rural communities.

Finally, Mr. Chairman, we encourage the committee to urge the Farm Credit Administration to abide by the direction given to it by Congress in the Farm Credit System Reform Act of 1996. Section 212(b) of that Act states the following: "The Farm Credit Administration shall continue the comprehensive review of regulations governing the Farm Credit System to identify and eliminate, consistent with law, safety and soundness, all regulations that are unnecessary, unduly burdensome or costly, or not based on law." FCA has yet to fully implement this statutory directive. Having them do so would go a long way toward providing Farm Credit institutions the flexibility they need to continue to serve farmers, ranchers and cooperatives into the future.

Thank you Mr. Chairman for allowing us to give our views on serving agriculture. During the upcoming

Farm Bill debate, we will suggest specific ways the Farm Credit Act can be updated to permit the System to continue to fulfill its mission of service to agriculture.

We look forward to working with the committee during consideration of the Farm Bill. Thank you again for the opportunity to present our views here today.